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Supreme Court of The United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
Petitioner,

v.

SHELL OIL COMPANY, ET AL.,
Respondents.

No. 77-1654

CONSUMER ENERGY COUNCIL OF AMERICA,
Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF RESPONDENTS TENNECO OIL COMPANY AND PENNZOIL COMPANY

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In The

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October Term, 1978

No. 77-1652

Federal Energy Regulatory Commission,
Petitioner,

v.

Shell Oil Company, et al.,
Respondents.

No. 77-1654

Consumer Energy Council of America,
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BRIEF OF RESPONDENTS TENNECO OIL COMPANY AND PENNZOIL COMPANY

OPINIONS BELOW AND JURISDICTION

The opinions below are correctly referenced and the jurisdictional prerequisites are adequately set forth in the brief of the Federal Energy Regulatory Commission (Commission).

QUESTION PRESENTED

Whether the Commission has jurisdiction to regulate the production activities of independent producers who sell gas in interstate commerce for resale.

STATUTES INVOLVED

Sections 1(b) and 7(b) of the Natural Gas Act, 15 U.S.C. §717(b) and 717f(b), are correctly set forth in the Commission's Petition for Writ of Certiorari.

STATEMENT

This case presents for review the Commission's Order No. 539-B. By that Order the Commission has undertaken to regulate the production processes and activities of natural gas producers who sell the natural gas they produce in interstate commerce for resale. The Commission has attempted to accomplish this objective in Order No. 539-B by (1) adopting a regulation pursuant to which all certificates for sales by independent producers issued after July 30, 1976 will impose a condition requiring the seller to develop and operate the property from which the gas will be produced as a prudent operator, and (2) asserting that all producer certificates issued prior to July 30, 1976 contain, by implication, an identical condition even though no such condition had theretofore ever been mentioned in any certificate. We believe, as did the Court of Appeals, that the Commission does not have the jurisdictional authority to regulate production processes and activities. Therefore, the Court of Appeals properly vacated Order No. 539-B.

The events which culminated in Order No. 539-B commenced with the issuance of Order No. 539 on October 14, 1975. That Order, which was issued without prior notice or the opportunity for comment by interested parties, added

a new Section 2.83 to the Commission's General Policy and Interpretations. Section 2.83(d) provided that every jurisdictional sale of gas by a producer is made subject to a "certificated minimum daily delivery obligation" and that Commission authorization must be obtained if the amount of gas produced and sold falls below the amount of that "obligation." Under Section 2.83(d), this "certificated minimum daily delivery obligation" was to be expressly stated as a condition in every certificate issued on or after October 14, 1975.

In response to numerous petitions for rehearing, the Commission in Order No. 539-A (issued March 26, 1976) instituted an informal rulemaking proceeding to consider the issues raised by Order No. 539.

After receipt of oral and written comments, the Commission issued Order No. 539-B on July 30, 1976. The Commission determined in that Order that the Section 2.83(d) condition which had been adopted in Order No. 539 was not in the public interest. Section 2.83 was therefore deleted from the Commission's regulations and the Section 2.83(d) condition was deleted from the certificates in which it had been imposed. At the same time, the Commission adopted Section 157.41 of its Rules and Regulations under which every certificate for a jurisdictional sale of natural gas will include, either explicitly or by implication, a condition requiring the seller of gas to operate the properties from which the gas is produced as a "prudent operator". Commissioner Watt dissented from the determination to adopt Section 157.41 and to impose the Section 157.41 condition in individual certificates on the grounds that the Commission does not have the authority to regulate production activities.

On review, the United States Court of Appeals for the Fifth Circuit vacated Order No. 539-B, holding that the Commission has no jurisdiction to regulate production

activities. Specifically, the Court held that Section 1(b) of the Natural Gas Act, as interpreted by this Court, expressly excludes the physical activities of production from the Commission's jurisdiction.

SUMMARY OF ARGUMENT

Section 1(b) of the Natural Gas Act confers on the Commission authority to regulate sales of gas in interstate commerce for resale.[1] However, such jurisdiction does not carry with it the authority to regulate the production of the gas sold. Rather, as Section 1(b) expressly provides, production is an activity separate and distinct from the sale of the gas produced. This critical distinction was recognized in the legislative history of the Natural Gas Act; this critical distinction has also been expressly and repeatedly recognized and carried forward in decisions of this Court, including the landmark decision in *Phillips Petroleum Company* v. *Wisconsin*.[2] Thus, although the Commission may have jurisdiction over the sale, it has no jurisdiction over the production activities preceding such sale.

The Commission suggests that it must have jurisdiction to regulate production in order to prevent a gap in the regulatory framework within which the natural gas industry operates. In fact, production is subject to regulation by both State agencies and federal regulatory bodies other than the Commission, as Congress intended. Regulation of such activities by the Commission would constitute an unauthorized intrusion into the domain of other regulatory bodies in contravention of the specific mandate of Congress.

[1] As a result of the recently enacted Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3352, certain interstate sales for resale are no longer subject to regulation under the Natural Gas Act. The impact of the NGPA on this case is discussed *infra* at 24-26.

[2] 347 U.S. 672 (1954) [hereafter cited as "*Phillips*"].

Recognizing the jurisdictional defect in the Commission's position, the Consumer Energy Counsel of America (CEC), Petitioner in No. 77-1654, launches a more subtle attack on the decision of the Court of Appeals. Conceding that Section 1(b) of the Natural Gas Act may exempt production activities by producers from the regulatory purview of the Commission (CEC Br. at 25-26), CEC contends that the Commission nevertheless can regulate such activities through imposition of a service obligation under Section 7 of the Natural Gas Act. However, the argument is circular. Imposition of a service obligation under Section 7 is necessarily premised upon an assumption that the Commission has been delegated the jurisdiction under Section 1(b) to impose such an obligation. Section 7 is not an independent delegation of authority but rather an enabling provision to allow the Commission to effectuate its Section 1(b) jurisdiction.[3]

ARGUMENT

I.

THE COMMISSION DOES NOT HAVE JURISDICTION TO REGULATE PRODUCTION ACTIVITIES

The Commission concedes that Order No. 539-B is an assertion of jurisdiction over the production activities of independent producers. Thus, the Commission acknowl-

[3] The second issue raised by CEC, the propriety of the "prudent operator standard," is not briefed herein. Because of its determination that the imposition of any standard governing production was beyond the Commission's jurisdiction, the Court of Appeals never considered the propriety of the standard imposed. In the event the Court of Appeals' decision is vacated, this issue should be remanded to the Court of Appeals for its review and determination, since it is the Court vested by Congress with the primary supervision of Commission actions. *E.g., Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 309-10 (1974). The issue not being ripe for review, Respondents Tenneco Oil Company and Pennzoil Company have not addressed it herein.

edged in Order No. 539-B that it was undertaking to regulate "... what a reasonably prudent *producer* would do with respect to the *drilling, completion, workover, recompletion or abandonment of wells*" (Comm. Pet. at 20a; emphasis added). Again, in its Petition for a Writ of Certiorari, the Commission recognized that its claimed jurisdiction under Order No. 539-B would allow it to oversee and regulate the normal operation and maintenance of individual wells (Comm. Pet. at 16). Finally, in its brief to this Court, the Commission asserts that it has power to determine and direct the steps to be taken by a producer in maintaining its wells and developing it leases, and that Order No. 539-B is an exercise of that authority (Comm. Br. at 22).

Thus, the Commission has not attempted to justify its order by suggesting that it is not an assertion of jurisdiction over production activities. Instead, the Commission attempts to justify its position on the grounds that jurisdiction over production activities is a necessary incident of its jurisdiction to regulate sales by producers.

Consequently, the issue in this case is clear cut and directly posed: Does the Commission's jurisdiction under Section 1(b) of the Natural Gas Act to regulate sales by producers in interstate commerce for resale carry with it the jurisdiction to regulate production of the gas which is sold? The answer is just as clear: the Commission has *no* jurisdiction over production processes or activities.

A. Section 1(b) of the Natural Gas Act, As Interpreted In The Phillips Decision, Precludes Commission Jurisdiction Over Production Activities.

The determinative authorities in this case are (1) Section 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), and (2) this Court's decision in *Phillips*. Section 1(b) is the source of all of the Commission's jurisdiction under the

Natural Gas Act. The *Phillips* decision delineates the bounds of that jurisdiction over independent producers.

Section 1(b) not only grants jurisdiction over specified activities, but also makes clear as a statutory matter the activities that are not included within the jurisdiction granted. Thus, Section 1(b) confers on the Commission jurisdiction over (1) transportation of natural gas in interstate commerce; (2) the sale of natural gas in interstate commerce for resale; and (3) natural gas companies engaged in such transportation or sale.[4] At the same time, Section 1(b) specifically provides that the provisions of the Natural Gas Act "shall not apply ... to the production of ... natural gas."

It is therefore clear that Congress in enacting the Natural Gas Act viewed the sale of natural gas as an activity separate and distinct from the production of that gas. Accordingly, Congress provided jurisdiction over the former but not the latter. Indeed, that is precisely the underlying basis upon which this Court in the *Phillips* decision concluded that the Commission had jurisdiction over sales by independent producers.

In *Phillips* the producers and the Commission contended that the sale of gas by an independent producer was incident to the production of the gas sold. They therefore contended that the affirmative grant over sales could not be interpreted as encompassing sales by producers because production (and the sale incident thereto according to the producers and the Commission) was excluded from the Commission's jurisdiction.

This Court rejected that contention, holding that sales by independent producers are subject to regulation under

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[4] *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949); *accord, FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972).

the Natural Gas Act. The basis for that holding was the determination that, as used in the Natural Gas Act, production is an activity separate and apart from the sale of the gas produced. As stated by the Court:

> ... production and gathering, in the sense that those terms are used in § 1(b) [of the Natural Gas Act], ended before the sales ... occur.[5]

Thus, this Court in *Phillips* held that the production exclusion did not preclude Commission jurisdiction over sales by producers because the sale of gas by a producer is not an incident of its production.

The instant case is simply the mirror-image of *Phillips*. If the sale of gas is not an incident of its production so that the sale by producers is not encompassed by the production exclusion, then conversely, the production of gas is not an incident of its sale. Thus, jurisdiction over production activities cannot be said to have been granted as an incident of jurisdiction over sales by independent producers. Instead, as this Court held in *Phillips,* the production of gas by a producer, and the subsequent sale of such gas by a producer, are two separate and distinct activities. Gas subject to the Natural Gas Act cannot be sold in interstate commerce for resale except as permitted by the Commission. The production of the gas is a matter totally beyond the Commission's jurisdiction, however.

B. The Legislative and Judicial History Confirms The Commission's Lack of Jurisdiction Over Production Activities.

The legislative history of the Natural Gas Act, as discussed in *Phillips,* is relied upon by both the Commission and CEC as support for their assertion that the Commission has jurisdiction over production activities under the

[5] 347 U.S. at 678.

Natural Gas Act. Petitioners assert that the legislative history shows that the "production and gathering" exclusion had no intended meaning, since the words were stated to be "not actually necessary." Therefore, they argue, the exclusion cannot be used to restrict the jurisdictional delegation of authority contained in Section 1(b) of the Act.

However, an examination of the actual legislative history relied upon by Petitoners reveals that exactly the opposite is the case. As set forth in *Phillips,* after quoting the provision of Section 1(b) which provides that the Natural Gas Act does not apply to production activities (as well as other specified activities), the committee report on the bill which became the Natural Gas Act states as follows:

> The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commission....[6]

In other words, the production "exclusion" is not really an exclusion at all because production does not come within and cannot fairly be read as coming within any of the jurisdictional delegations contained in Section 1(b). Thus, the Natural Gas Act's legislative history makes clear what is already apparent from the very words of the Act: the legislative delegation of jurisdiction over sales of natural gas does not include a grant of jurisdiction to regulate the production of the gas so sold.

The legislative history of the Natural Gas Act is pertinent for yet another reason. As discussed in *Phillips:*

> There can be no dispute that the overriding congressional purpose was to plug the "gap" in regulation of natural-gas companies resulting from judicial decisions prohibiting, on federal constitutional grounds, state

[6] *Id.* at 683.

> regulation of many of the interstate commerce aspects of the natural-gas business.[7]

Specifically, sales in interstate commerce for resale had been deemed to be beyond state regulatory powers even when Congress had not occupied the field. *See Public Util. Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *Missouri* v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924). As stated in the committee report on the bill that became the Natural Gas Act:

> The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.
>
> • • • •
>
> The bill takes no authority from State Commissions, and is so drawn as to complement and in no manner usurp State regulatory authority....[8]

As clearly as the *Kansas Gas* and *Attleboro Steam* cases resulted in the gap that was to be closed by the passage of the Act in 1938,[9] this Court's 1931 decision in *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210 (1931), makes clear there was no regulatory gap with respect to production activities. In *Champlin*, this Court rejected the contention that the states are powerless to regulate the production of a commodity thereafter sold in interstate commerce, stating:

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[7] *Id.* at 682-83 (footnote omitted).

[8] H.R. REP. No. 1162, 75th Cong., 1st Sess. 2 (1937).

[9] CEC's reliance upon *Interstate Natural Gas Co.* v. *FPC* 331 U.S. 682 (1947) is wholly unfounded. That case specifically involved a situation in which the Petitioner in that case had tried to create a gap notwithstanding the passage of the Natural Gas Act. As noted at p. 687 n. 9 of that decision, that Petitioner had asserted that the state had no power to regulate the sale because it was in interstate commerce at the same time that it was arguing to the Commission that it did not have any jurisdiction over the sale.

> It is clear that the regulations prescribed and authorized by the [state] commission apply only to production and not to sales or transportation of crude oil or its products. Such production is essentially a mining operation and therefore is not a part of interstate commerce even though the product obtained is intended to be and in fact is immediately shipped in interstate commerce.[10]

Thus, as of 1938 — when the Gas Act was passed — this Court had drawn the basic distinction between the activities of production of products subsequently sold in interstate commerce and the sale of the products so produced. Indeed, this distinction was so sharp as to provide the basis for a difference in this Court's view of the state's powers with respect to such activities. According to *Champlin*, the states had the power to regulate production of products to be sold interstate. However, according to *Attleboro Steam* and *Kansas Gas*, the states did not thereby accrue the power to regulate sales in interstate commerce of the commodity produced.

This distinction between production and sale, and the treatment of the two activities as being separate and distinct, was expressly incorporated into the Natural Gas Act. The activities which this Court had held to be beyond state authority, wholesales of natural gas in interstate commerce, were subjected to Federal regulation. And because the basic purpose of the Natural Gas Act was simply to bring under Federal regulation matters which were beyond state control, those matters which were not beyond state control, such as production activities, were expressly excluded from the Commission's jurisdiction. The Commission's contention to the contrary ignores not only the plain words of the statute, but the legislative and judicial history underlying the Natural Gas Act as well.

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[10] 286 U.S. at 235.

C. This Court Has Consistently Affirmed The Validity of the Production Exemption.

This Court's determination in *Phillips* that production is an activity separate and distinct from sale of the gas produced so that the grant of sales jurisdiction cannot and does not carry with it authority over production activities is consistent with this Court's treatment of Section 1(b) both before and after *Phillips*. Thus, in *Colorado Interstate Gas Co.* v. *FPC*,[11] this Court described the reach of the production exemption as follows:

> Certainly that provision precludes the Commission from any control over the activity of producing or gathering natural gas. For example, it makes plain that the Commission has no control over the drilling and spacing of wells and the like.[12]

This Court again addressed the meaning of the Section 1(b) production exemption in *FPC* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949). The Court first recognized that Section 1(b) contains not only a grant of jurisdiction, but also expressly identifies areas not included within the jurisdictional grant. Among the activities which the Court recognized as being expressly excluded from the Commission's jurisdiction is ". . . the production and gathering of natural gas."[13] Referring to the scope of the production exemption as set forth in *Colorado Interstate*, the Court once again adhered ". . . to this natural and clear meaning of the words and their obvious expression of congressional intent."[14] Indeed, in *Panhandle* the Commission itself expressly recognized in its argument to the Court that "the activities of production and gathering,

[11] 324 U.S. 581 (1945).

[12] *Id.* at 602-3.

[13] 337 U.S. at 504.

[14] *Id.* at 504-5.

such as drilling, spacing wells, or collecting gas . . . were excluded from the coverage of the Act."[15]

Finally, in *United Gas Improvement Co.* v. *Continental Oil Co.*, 381 U.S. 392 (1965) (the *Rayne Field* case), this Court again reiterated the distinction between the production and the sale of natural gas. There, the Court concluded that merely because the gas was sold before production — being a sale of gas in place — the Commission did not thereby lose its jurisdiction to control the price at which such gas was sold. Under the Court's analysis, the Commission had price jurisdiction over the sale without regard to the timing of the transactions, i.e., whether the sale occurred before, during, or after production. However, the Court made clear that this in no manner interfered with or nullified the statutory preclusion of Commission jurisdiction over production activities. As stated by the Court:

> [T]he "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdiction. This *accomodation* of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in Phillips, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.[16]

Thus, the Court's decision in *Rayne Field* carries forward the distinction between production processes and activities, which are subject to state regulation, and sales in interstate commerce, which are not, first set out by this Court before the passage of the Natural Gas Act and consistently recog-

[15] *Id.* at 504.

[16] 381 U.S. at 402-03 (emphasis added).

nized thereafter. Equally importantly, this Court again emphasized in *Rayne Field* the preservation of the states power over production and that accordingly, the affirmative delegation of jurisdiction in Section 1(b) must be *accomodated* with the statutory denial of jurisdiction in the same section, not nullified. Thus, Petitioners' argument that the "production" exemption in Section 1(b) does not limit the affirmative jurisdiction granted thereunder has already been rejected by this Court and should again be rejected in the instant case.

D. Section 7(b) Does Not Confer Jurisdiction Over Production Activities.

As has been set out, the Commission's effort to regulate production activities by claiming that production is an incident of sale is precluded by Section 1(b), the *Phillips* case, the Natural Gas Act's legislative history, and the other consistent holdings of this Court. It is therefore not surprising that both the Commission's and the CEC's brief treat Section 1(b) in a cursory manner and emphasize instead Section 7(b). In this regard, the Commission states that it has jurisdiction under Section 7(b) to prevent the termination of service without prior Commission authorization being obtained. The Commission relies on *Sunray Mid-Continent Oil Co.* v. *FPC,* 364 U.S. 137 (1960) and *California* v. *Southland Royalty Co.,* 98 S. Ct. 1955 (1978).

This general principle adds nothing to the resolution of this case, however. For, as *Sunray* makes clear, Section 7(b) "regulates the abandonment by natural-gas companies of . . . *services subject to the jurisdiction of the Commission.*"[17] Thus, inevitably the inquiry must return to Section 1(b) for that Section is the sole source of the "services subject to the jurisdiction of the Commission."

[17] 364 U.S. at 141.

As established above, the service over which the Commission has jurisdiction is the *sale* of the gas which is produced. Thus, as in *Sunray,* an independent producer cannot, without Commission approval, discontinue *selling* to the interstate purchasers *the gas which is produced* simply because the contract with that purchaser has expired. Nor, according to *Southland,* can a reversionary interest owner terminate the *sales to an interstate purchaser of the gas produced* from acreage at one time covered by a fixed term lease when such lease expires unless Commission authorization is obtained.

On the other hand, the Commission's authority to insure that gas which is produced is *sold* in interstate commerce most assuredly does not carry with it the authority to compel or regulate the rate of production of that gas. For both Congress and this Court have determined that production is not an incident to sale. The Commission's boot-strap attempt to create jurisdiction through Section 7(b) when Section 1(b) confers no such jurisdiction must fail.

Furthermore, any suggestion that the Court of Appeals decision undermines Section 7(b), *Sunray* or *Southland* is simply wrong. The Commission has full authority to compel producers to sell in interstate commerce gas which is produced from dedicated acreage. But it has no authority to compel or direct production activity. That authority was left by Congress to the states.

This is not the first occasion the Commission has attempted to avoid the express exclusion of production from its jurisdiction by attempting to rely on the powers conferred under the non-jurisdictional sections of the Act. Precisely the same argument was made and rejected in *FPC* v. *Panhandle Eastern Pipe Line Co.*[18] The production

[18] 337 U.S. 498 (1949).

activity over which the Commission sought jurisdiction in that case was the transfer by a pipeline company of undeveloped oil and gas leases. In asserting that it did have the requisite jurisdiction despite Section 1(b), the Commission relied on its powers under Sections 4, 5 and 7 of the Act. Specifically, the Commission pointed out that the reserves underlying the leases had been set forth as a part of the gas supply warranting expansions of service under three Section 7 certificates and that Panhandle had included the reserves in its rate base. The Commission argued, just as it does in this case, that its power under Section 7(b) to prevent abandonments conferred jurisdiction over production activities. But this Court pointed out that the powers conferred by Sections 4, 5 and 7 are applicable only to matters over which the Commission has jurisdiction under Section 1(b):

> Sections 4, 5 and 7 do not concern the producing or gathering of natural gas; rather they have reference to the interstate sale and transportation of gas and are so limited by their express terms.
>
> • • • •
>
> Nothing in the sections indicates that the power given to the Commission over natural-gas companies by § 1(b) could have been intended to swallow all the exceptions of the same section and thus extend the power of the Commission to the constitutional limit of congressional authority over commerce. The repetition of the words 'subject to the jurisdiction' makes clear to us the intent to keep the Commission's hand out of the excepted local matters.[19]

Order No. 539-B is an even clearer attempt to circumvent the Section 1(b) production exemption than was the attempt in *Panhandle*. Although unsuccessful, the Commission in *Panhandle* at least attempted to deal with the

[19] *Id.* at 508.

Section 1(b) production exemption by arguing that the exemption applied to the activities of production, but not to the facilities of production, such as leases. In the present case, the Commission has acknowledged that its Order asserts jurisdiction over production activities. Indeed, whether a producer is a "prudent operator" encompasses every phase of the activities of production. This pervasive attempt to strip all meaning from the production exemption makes prophetic this Court's comments as to the inevitable results of endorsing the Commission's position in *Panhandle*:

> To accept these arguments springing from power to allow interstate service, fix rates, and control abandonment would establish wide control by the Federal Power Commission over the production and gathering of gas. It would invite expansion of power into other phases of the forbidden area.[14] It would be an assumption of powers specifically denied the Commission by the words of the Act as explained in the report and on the floor of both houses of Congress.

[14] Would it soon be contended that statutory power to require extension of service, § 7(a), included power to require exploration or acquisition of leases . . . . in order to serve the public interest?[20]

Even without the invitation of "expansion of power into other phases of the forbidden area" which the Court refused to issue in Panhandle, the Commission now asserts that it has authority over the entire forbidden area.

The *ultra vires* nature of the Commission's effort is evident on the face of Section 7 itself. Under Section 7(a), the Commission is delegated the authority to "direct a natural-gas company to extend or improve its *transportation* facilities . . ." (emphasis added). However, the statute nowhere grants the Commission an analogous authority to

[20] *Id.* at 509. (f.n. 15 omitted).

order a "natural-gas company" to extend or improve its *production* facilities. Further, it has been specifically held that even though the Commission has the power to order the extension or improvement of transportation facilities, it has no power to order an enlargement of facilities.[21] Yet the Commission here claims nothing less under Order No. 539-B than the power to order the extension, improvement and enlargement of production facilities. Thus, the Commission's contention is that Congress delegated broader authority over producer activities by its silence in Section 7 than it gave over transportation activities by specific directive. Particularly in light of the exclusionary language in Section 1(b), the Commission's interpretation does violence to the expressed terms of Section 7.

CEC's argument that Congress' refusal to delegate to the Commission jurisdiction over production under Section 1(b) can be overcome by reference to the services obligation imposed by Section 7[22] is similarly uncompelling. CEC's proposed alternate to the Commission's "prudent operator standard" would require a producer to approach the Commission any time it incurs a decline in the level of service under a certificate, however the level of service were defined.[23] This argument is merely an exercise in semantics. Any well suffers a "decline in service" throughout its production history as the reservoir is produced and reserves depleted. No less than the "prudent operator standard," this "service" standard would imbue the Commission with the power to order a producer to extend, improve, or expand its production facilities. Thus, not only does CEC's alternative fail because of the absence of any such authority invested in the Commission

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[21] *See Central West Util. Co.* v. *FPC*, F.2d 306 (3d Cir. 1957).

[22] CEC Brief at 58.

[23] CEC Brief at 58-9.

under Section 7, but it also fails because at bottom, the standard necessarily assumes Commission jurisdiction over production activities in order to exercise its authority.

In short, Section 7 of the Natural Gas Act in no manner expands Commission jurisdiction under Section 1(b). Section 7 is *not* an independent delegation of jurisdiction. Rather, Section 7 only implements, and is therefore delimited by the jurisdictional delegation of power contained in Section 1(b).

E. There Is No Regulatory Gap Involved in the Instant Case.

The Commission and CEC both posit that a regulatory gap arises if the Commission's jurisdiction is not affirmed in the instant case. However, an examination of previous decisions of this Court, legislative enactments subsequent to the passage of the Natural Gas Act, and the standard adopted by the Commission itself reveals that not only is there no regulatory gap, but that the system *without* Order No. 539-B is exactly that contemplated by Congress in enacting the Natural Gas Act.

To put this argument in the proper perspective, it is essential to reiterate the predicate for the Natural Gas Act. That Act was passed to close the hiatus which the courts had found to exist because of constitutional prescriptions against state regulation of interstate commerce. It was not intended to invade the province of the states as to those areas in which they clearly had the power to regulate. Thus, the regulatory scheme under the Natural Gas Act is a bifurcated structure: the states are allowed to regulate activities of producers to the maximum extent contemplated under the Constitution, and federal authority, delegated to the Commission, covers the areas in which the states are constitutionally precluded from regulating.

Even before the Natural Gas Act, this Court in *Champlin* recognized the power of the states to regulate production. It was contemplated under the Natural Gas Act that the states would continue to exercise that function. Indeed, the Commission has effectively conceded the efficacy of the standard — the "prudent operator standard" — by adopting the standard as the basis for assuring that service will be maintained.[24]

Thus, there is no claim that the states do not have a standard which will assure continuation of production in feasible circumstances. Nor is there any claim that the states have not administered that standard properly, as indeed the Commission claims that it will administer the standard in conformity with the interpretation of that standard by the various states.[25] Rather, the Commission merely asserts that its exercise of that power is necessary to administer its responsibilities under the Natural Gas Act. The answer is simply that Congress did not consider it necessary to vest that power in the Commission under Section 1(b) of the Natural Gas Act in order for it to effectuate its power under Section 7. Rather, the states were perceived as having the power to fulfill the underlying production enforcement responsibility which would then enable the Commission to exercise its Section 7 responsibilities. Thus, there is no regulatory gap. However, if the system as contemplated and designed by Con-

[24] Order No. 539-B at 8; Commission Brief at 31.

[25] Comm. Brief at 31-32. This assertion by the Commission disposes of the CEC's claim that the "prudent operator standard" is not necessarily consistent with the concept of service under Section 7 of the Natural Gas Act. CEC's Brief at 39. Obviously, the Commission perceives no such inconsistency between the "prudent operator standard" as enforced by the states and Section 7 service obligations. Indeed, counsel for the Commission conceded before the Court of Appeals that there was no evidence that producers were withholding supplies under the existing system. App. at 3a.

gress is not working, and there is simply no evidence in this proceeding that it is not, then the Commission's remedy is with Congress.[26]

Congress, however, has indicated no dissatisfaction with the regulatory framework established by the Natural Gas Act. To the contrary legislative enactments of Congress subsequent to the passage of the Natural Gas Act have maintained the regulatory dichotomy first established under the Natural Gas Act between production activities and sales.

Thus, with respect to the offshore Federal domain, Congress, under the Outer Continental Shelf Lands Act,[27] first placed the regulation of offshore production in the hands of the Department of Interior, not the Commission. Interior has discharged this statutory responsibility through the United States Geological Survey and has adopted regulations covering in detail every aspect of production from offshore Federal domain acreage.[28] Those regulations provide, in essence, that the operator of an offshore lease must conduct operations as a prudent operator. 30 C.F.R. § 250.33(d).

With the enactment in December, 1975 of the Energy Policy and Conservation Act, Congress once again made its determination that the regulation of development and production of gas reserves is a matter for the Depart-

[26] This appears to be the major thrust of CEC's brief, *i.e.*, that the current administration of the "prudent operator standard" is not consistent with their concept of the "public interest". Necessarily, in light of the bifurcated system envisioned and created by Congress in enacting the Natural Gas Act, such an argument is a legislative one more appropriately addressed to the legislative body which created the existing system – the United States Congress.

[27] 43 U.S.C. § § 1331-1343.

[28] 30 C.F.R. § § 250.1, *et seq*. Production from federal lands onshore is governed by the Federal Mineral Leasing Act, 30 U.S.C. § 181, *et seq*. (1971).

ment of the Interior and the states. Section 106 of the Act[29] deals with the precise area into which the Commission has intruded under Order 539-B. Section 106 provides that Interior shall determine the maximum efficient rate of production from fields containing gas reserves located on federal lands. The maximum efficient rate is that rate which can be sustained without loss of ultimate recovery of gas "under sound engineering and economic principles".[30] Under Section 106(a)(2)(A), the President may require gas production from Federal lands at the maximum efficient rate established by Interior.

The Energy Policy and Conservation Act also deals with gas production from non-federal lands. Just as it was in the Natural Gas Act, jurisdiction over such production was reserved to the states. Under Section 106(b)(1) of the EPCA, the determination of a maximum efficient rate of production from non-federal lands is reserved to the discretion of the appropriate state regulatory bodies.

Finally, in the Department of Energy Organization Act Congress once again dealt with the regulatory structure relating to production from Federal lands. In that Act, Congress transferred some of the Secretary of Interior's functions relating to the production rate and diligence requirements on Federal leases to the Secretary of Energy.[31]

Production activity is, therefore, fully regulated. Indeed, the Commission recognizes the existence of regulatory authority in other regulatory bodies, both state and federal, and even suggests that Order No. 539-B will not impose any regulatory standard different than that which

[29] 42 U.S.C. § 6214.

[30] 42 U.S.C. § 6214(e)(1).

[31] 42 U.S.C. § 7152(b).

is already in existence (Comm. Br. at 32). Thus, the Commission's true position is not that there is a regulatory gap in which there is no regulation of production activities. Rather, the Commission's true position is that there can be no effective regulation of production activities unless the Commission administers that regulation. This presumptive overreaching and intrusion into the authority of other regulatory bodies by administrative fiat must be rejected. There is no regulatory gap resulting from the Section 1(b) production exemption. Instead, regulation of production is being accomplished precisely as Congress intended.

F. The Commission May Not Extend Its Jurisdiction by Asserting That Its Actions Are in the Public Interest.

The Commission's underlying theme throughout this proceeding, and one echoed by CEC, is that production activities of producers must be controlled to protect the "public interest." However, the "public interest" does not serve as some totem determining the limits, or the propriety of extension, of Commission jurisdiction. Rather, as stated in *Mobil Oil Corporation* v. *FPC:*

> The FPC is to be commended for attempting to further that objective, but it is not a sufficient justification upon which to base an expansion of the [Natural Gas] Act to activities clearly not within its terms. Congress did not give the FPC carte blanche to take whatever action it might consider appropriate in furtherance of this purpose. The FPC is limited by the provision establishing its jurisdiction . . . .[32]

[32] 463 F.2d 256, 263 (D.C. Cir.), *cert. denied*, 406 U.S. 976 (1972).

II.

THE IMPACT OF THE NATURAL GAS POLICY ACT OF 1978

The Natural Gas Policy Act of 1978 (NGPA)[33] was signed into law on November 9, 1978. That Act alters to a significant degree the Commission's jurisdiction under the Natural Gas Act. As the Commission correctly points out in its Brief (Comm. Br. at 16), however, most of the gas that was flowing in interstate commerce on November 8, 1978 remains subject to the Commission's regulatory authority under the Natural Gas Act. We therefore agree with the Commission that this case remains one of extreme significance.

The Commission is also correct in pointing out that, as a result of the NGPA, certain sales in interstate commerce for resale will not be subject to regulation under the Natural Gas Act. Specifically, most sales in interstate commerce for resale commenced on or after the NGPA's date of enactment (November 9, 1978) will not be subject to such regulation. NGPA, § 601(a)(1)(A). In addition, certain gas which was committed to interstate commerce as of November 8, 1978, including new natural gas as defined in the NGPA, will no longer be subject to such regulation. NGPA, § 601(a)(1)(B). Of interest so far as this case is concerned is the method by which Congress removed such gas from the coverage of the Natural Gas Act. Congress accomplished that objective simply by removing such gas from the coverage of Section 1(b) of the Natural Gas Act. Reference to Section 1(b) alone was sufficient because, as we have shown, Section 1(b) is the only source of the Commission's jurisdiction under the Natural Gas Act.

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[33] Pub. L. No. 95-621, 92 Stat 3352 (1978).

While we generally agree with the Commission that this case remains a significant one, we disagree with the Commission's assertions as to the NGPA in three particulars.

First, the Commission implies that all future sales from reserves committed to interstate commerce as of November 8, 1978 remain subject to Natural Gas Act jurisdiction. In fact, under Section 601(a)(1)(B) of the NGPA, new gas, certain high-cost gas, and gas from new onshore production wells[34] is no longer subject to such jurisdiction even if it was committed to interstate commerce as of November 8, 1978.

In addition, the Commission is in error when it suggests that the provision of Order 539-B requiring the imposition of the prudent operator standard in future certificates will have no effect after November 8, 1978. Gas from the offshore Federal domain is included within the definition of "committed or dedicated to interstate commerce" for purposes of the NGPA regardless of whether it was contracted to an interstate purchaser prior to November 8. NGPA § 2(18)(A)(i). Therefore, offshore Federal domain gas is removed from regulation under the Natural Gas Act only if it falls within one of the categories specified in Section 601(a)(1)(B). Consequently, if offshore Federal domain gas which is not either new gas or high-cost gas has not yet been certificated, a certificate under the Natural Gas Act will be required. Therefore, the requirement of Order No. 539-B that all future certificates contain a production condition has not been rendered moot by the NGPA.

Finally, the Commission and CEC contend that Order No. 539-B is necessary to avoid the diversion of natural

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[34] New gas is defined in Section 102(c), high-cost gas is defined in Section 107(c)(1)(2)(3) and (4), and new onshore production well is defined in Section 103(c) of the NPGA.

gas committed or dedicated to interstate commerce under the Natural Gas Act into higher priced or deregulated categories under the NGPA. In fact, the NGPA eliminates this concern by empowering the Commission to review all determinations allowing gas from any new well to qualify for a higher maximum lawful price under a particular provision of the NGPA.[35] No distinction, for purposes of the NGPA, is drawn between gas flowing in interstate commerce and gas flowing in intrastate commerce; both are covered. Therefore, the Commission will be able to police any attempted diversion without resorting to any "prudent operator standard" or any other assertion of jurisdiction over production activities.

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[35] § 503(b), 92 Stat. 3396.

CONCLUSION

In sum, this Court has repeatedly found that the provision establishing the Commission's jurisdiction under the Natural Gas Act — Section 1(b) — specifically denies the Commission jurisdiction over production activities. The Court of Appeals, following the mandate of this Court in those decisions, properly determined that since Order No. 539-B concededly attempted to regulate production activities, the Commission had exceeded the limits of its jurisdiction in issuing that Order. Therefore, the decision of the Court of Appeals vacating Order No. 539-B should be affirmed.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served this Brief on all parties on December 22, 1978, in accordance with the rules.

STEPHEN M. HACKERMAN